79-9091

Supreme Court, U. S.
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UNITED STATES OF AMERICA

IN THE SUPREME COURT

RAYMOND E. SMITH,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

/

Supreme Court
No.

Court of Appeals
Sixth Circuit
No. 79-5111

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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NOW COMES RAYMOND E. SMITH, Petitioner, by his attorney, RONALD T. HUBBARD, and petitions and prays that a Writ of Certiorari issue to review the judgment heretofore entered against Petitioner by the United States Court of Appeals for the Sixth Circuit, and in support thereof says as follows:

1. OPINIONS BELOW

Petitioner RAYMOND E. SMITH was indicted in a three (3) count indictment returned April 13, 1978 by the Federal Grand Jury for the Eastern District of Michigan, Southern Division. He was charged with having willfully and knowingly attempted to evade and defeat the payment of federal income taxes for the years 1971, 1972, and 1973 in violation of Section 7201, Title 26, United States Code. Petitioner was tried in the United States District Court for the Eastern District of Michigan, Southern Division, before the Honorable James P. Churchill, sitting with a jury. Petitioner RAYMOND E. SMITH was convicted. Following the imposition of sentence, Petitioner RAYMOND E. SMITH appealed to the United States Court of Appeals for the Sixth Circuit. The conviction was affirmed. A copy of the opinion of United States Court of Appeals for the Sixth Circuit, decided and filed November 13, 1979, is annexed as Appendix A.

2. JURISDICTION

The opinion of the United States Court of Appeals for the Sixth Circuit was filed on November 13, 1979. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

3. STATEMENT OF QUESTION INVOLVED

Whether the District Court erred in denying the Petitioner's motion for a judgment of acquittal given the failure of the government to investigate relevent and exculpatory pretrial leads resulting in a failure of the government's trial proofs to establish with reasonable certainty, the accuracy of the Petitioner's opening net worth.

4. STATUTE

The statute under which Petitioner Smith was convicted is as follows:

> "26 U.S.C. §7201. Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution."

5. STATEMENT OF THE CASE AND STATEMENT OF FACTS

Petitioner RAYMOND E. SMITH was indicted in a three (3) count indictment returned April 13, 1978 by the Federal Grand Jury for the Eastern District of Michigan, Southern Division (Appendix 3a). He was charged with having willfully and knowingly attempted to evade and defeat the payment of federal income taxes for the years 1971, 1972, and 1973 in violation of Section 7201, Title 26, United States Code. Specifically the government charged the following understatement of income:

COUNT	TAXABLE INCOME PER TAX RETURN	TAXABLE INCOME PER INDICTMENT
One	-0-[1]	$31,244.03
Two	$1,506.00	$30,677.86
Three	($5,676.68)[2]	$34,207.02

The government's case utilized the net worth method of proof (Appendix 110a). The net worth reconstruction offered, exclusive of the determination of cash on hand, was stipulated to by the defense.[3] The petitioner's defense and explanation was that the net worth increases were attributable to prior accumulated cash. Thus, there emerged dual focal points: The accuracy of the estimate of opening net worth, and the extent to which available leads to opening cash on hand had been investigated by the government.

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[1]Petitioner did not file a federal income tax return for the year 1971.

[2]Petitioner reported a loss on his 1973 federal income tax return.

[3]The final net worth amount stipulated varied slightly in amount from that in the indictment.

In the government's case-in-chief, Special Agent Dominic Tomburrini testified to the investigative procedures utilized by the government in reconstructing the petitioner's opening net worth. On cross-examination he testified as follows: (Appendix 15a).

> Q. "Were you told by anyone at Service Envelope[4] that Mr. Smith had made a statement on at least one occasion that he had enough cash set aside to live on for at least six or seven years, that he didn't need the job at Service Envelope?"
>
> A. "Yes, I was told that, yes, sir."
>
> Q. "Did you go back and check his Army record? Did you interview anybody that served with him in the Army as to sources of income during that period of time?"
>
> A. "No. I was not able to do that, sir."
>
> Q. "Did you go into the neighborhoods, into the inner city to where Mr. Smith grew up, where he was living? Did you interview any of his associates, friends, to determine whether he was involved in any other activities other than working for Service Envelope during the 1960's and through 1970?"

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[4]The petitioner was employed as a pressman at a printing company, Services Envelope Company, for the period 1957 through March 25, 1971. (Appendix 36a)

A. "Well, I interviewed a neighbor who prepared his return for 1969 and 1970, who I believe was a neighbor of Mr. Smith when Mr. Smith was a small child."

Q. "Did you interview any people that he was likely to be associated with during those years to find out whether he was involved in any other activities that might have given him some cash?"

A. "No. I didn't have anyone's name to interview."

On direct examination, Joseph Wilson, a former employee of the Service Envelope Company, testified to a conversation he had with the petitioner on September 29, 1970. (Appendix 48a). During that conversation, petitioner stated he could make "$700.00 a night on the streets". Wilson also testified that the petitioner told him that he had made enough money on the outside so that he "wouldn't have to work for six or seven years." (Appendix 51a). Wilson did not recall the exact date of the latter statement, but it could not have occurred later than March 25, 1971, the petitioner's last day of employment at the Service Envelope Company. The petitioner took sick leave from his employer on November 16, 1970 and returned on March 22, 1971. (Appendix 32a).

During further examination of the government's witnesses, the following was established with regard to the petitioner's activities during the pre-prosecution years:

1. He was observed with large sums of money. (Appendix 52a).

2. He loaned money at high interest rates. (Appendix 71a).

3. He gambled successfully. (Appendix 62a).

4. He was fired from his job because it was alleged that he sold envelopes in competition with his employer during the period of his sick leave. (Appendix 51a).

5. He may have had an interest in a photography studio. (Appendix 52a).

6. He may have had an interest in a business renting security dogs. (Appendix 12a).

The government's net worth computation determined that the petitioner's opening net worth as of December 31, 1970 consisted of Three Thousand Six Hundred Forty-Three and 20/100 ($3,643.20) Dollars, which consisted solely of a 1966 automobile (Appendix 111a). The Special Agent and the Revenue Agent, Joseph Miller, testified that the opening cash on hand could not be determined (Appendix 78a, 81a). The government's net worth contained a "dash" in place of opening cash. The revenue agent explained the use of the dash as follows: (Appendix 78a).

> "I make a distinction between a dash and a zero. That distinction is that I cannot determine the amount of cash that the defendant had in his pocket or in his house as of December 13, 1970, and for each of the other years."

The government placed into evidence the employer's (Service Envelope Company) retained copies of the petitioner's forms W-2 for the period 1957 through 1971 (Appendix 78a). The Special Agent and the Revenue Agent testified that they examined the above documents and concluded that the petitioner could not have accumulated a cash hoard sufficient to explain the subsequent net worth increases. (Appendix 11a, 80a). In addition, the Revenue Agent testified that he examined the petitioner's tax return for 1968 through 1970 in reaching his conclusion, although he did not testify as to the amounts on the returns, only his conclusion. (Appendix 10a). The government did not offer any direct evidence to dispute the claimed cash hoard but instead relied upon an inference that the amounts reflected on the W-2 forms precluded the existence of the cash hoard.

At the close of the government's proofs, the petitioner argued that the government had failed to investigate exculpatory leads or to seek independent third party corroboration of the cash hoard defense. The petitioner moved for a Judgment of Acquittal based upon the insufficiency of the proof. (Appendix 97a). The denial of that motion was the basis for the appeal to the Sixth Circuit Court. (Appendix 107a).

The petitioner took the stand in his own defense. The jury acquitted the petitioner as to Count Three and returned a verdict finding the petitioner guilty on Counts One and Two upon which a judgment of conviction was entered. The sentence imposed was one (1) year imprisonment, plus fines totaling Twenty Thousand ($20,000.00) Dollars. A motion for appeal was heard on March 30, 1979 and appeal bond granted.

6. ARGUMENT

I.

WHETHER THE DISTRICT COURT ERRED IN DENYING THE PETITIONER'S MOTION FOR A JUDGMENT OF ACQUITTAL GIVEN THE FAILURE OF THE GOVERNMENT TO INVESTIGATE RELEVANT AND EXCULPATORY PRE-TRIAL LEADS RESULTING IN A FAILURE OF THE GOVERNMENT'S TRIAL PROOFS TO ESTABLISH WITH REASONABLE CERTAINTY THE ACCURACY OF THE PETITIONER'S OPENING NET WORTH.

SUMMARY OF ARGUMENT:

Reversal is urged for the failure of the government to establish guilt beyond a reasonable doubt.

In the typical tax fraud prosecution utilizing the inferential "net worth method of proof"[1], in order to establish the existence of the unreported taxable income, the government must present evidence with respect to three burdens: (1) proof establishing an "opening net worth", (2) proof establishing the increases in the taxpayer's net worth for each succeeding taxable year and (3) proof as to a likely source of taxable income or proof negating all non-taxable sources of income. In the lower court, and here, the second burden - the increases in wealth -

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[1]The net worth method of proof is a means employed to circumstantially reconstruct the taxable income of a taxpayer during a time certain. The critical starting point is an accurate setting forth of a beginning net worth which accurately reflects the taxpayer's "balance sheet" of assets and liabilities. If that worth is incorrectly underevaluated (for example, cash on hand), subsequent asset increases appear to arise from currently taxable income, as opposed to a reduction of previously accumulated assets (for example, cash on hand).

insofar as they were evidenced by the purchase of certain assets- were not and are not, contested. However, it was there argued, renewed herein, that the proofs offered by the government in their first burden - the establishment, with reasonable certainty, of a reliable beginning net worth figure - were hopelessly deficient. The government's proof gave no credit whatsoever to the petitioner's cash on hand as of December 31, 1970. That failing, commited in total disregard of ample trial testimony indicating the existence of a cash hoard, necessarily and improperly placed before the jury the power to conclude proof beyond a reasonable doubt when, as a matter of law, the uncertainty of that opening net worth should have precluded the jury from even contemplating such a conclusion. Moreover, that failing arose, unnecessarily, because the government, having misunderstood its trial burden, elected to disregard its responsibility to investigate exculpatory leads available to them in advance of trial. That failure, to investigate matters which were susceptible of investigation, thereafter denied the trier of fact the opportunity to weigh all the potential evidence about the available sources of cash to which leads had been given. The jury could not, therefore, conclude that the petitioner's cash-on-hand was insufficient to explain the alleged understatement of taxable income. It perilously, in a classic manner, shifted to the petitioner the burden of himself establishing his opening net worth with reasonable certainty. Ensnarled in this web of misleading figures, he was thereby forced to take the stand and attempt to reconstruct that which the government, with all of its investigative powers, had not even attempted.

The beginning net worth figure is then subtracted from the closing net worth at the end of the taxable period in question. For obvious reasons, that figure must be equally accurate. The difference is then added to nondeductible expenses (food, clothes, etc.). That

The trial court erred in failing to impose those fundamental safeguards which require the government to prove every element of the offense beyond a reasonable doubt.

LAW AND ANALYSIS -- THE LEADS DOCTRINE

The net worth method of proof in income tax evasion cases was first sanctioned by the Supreme Court in Holland v U.S., 348 U.S. 121 (1954). The court immediately recognized the dangers inherent in this method of proving criminal conduct and admonished the Courts regarding the need for close and sensitive review in net worth prosecutions.

The court said at 129:

> "...Trial courts should approach these cases in the full realization that the taxpayer may be ensnared in a system which, though difficult for the prosecution to utilize, is equally hard for the defendant to refute..."
>
> "...Appellate courts should review the cases, bearing constantly in mind the difficulties, that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation."

The Supreme Court realized that it had given the Sword of Damocles to federal law enforcement; a "powerful method" of proving tax crimes, which in the absence of proper standards of administration could result in serious injustices. Therefore, in order to establish

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sum, arrived at circumstantially and in reliance upon the accuracy of the figures being manipulated, is then presumed to represent taxable income. It is then the prosecutorial task to test that presumption by proving a likely source of such income or, alternatively, by negating all sources of nontaxable income.

judicial safeguards against the unrestrained use of the net worth method, the court imposed upon the government the obligation to investigate relevant leads. This requirement has come to be known as the "Leads Doctrine".

The court said at 136:

> "It is, of course, not for us to prescribe investigative procedures, but it is within the province of the courts to pass upon the sufficiency of the evidence to convict. When the government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt. Such refutation might fail when the government does not track down relevant leads furnished by the taxpayer- leads reasonably susceptible of being checked- which, if true, would establish the taxpayer's innocence. When the government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the government's case insufficient to go to the jury. This should aid in forestalling unjust prosecutions, and have the practical advantage of eliminating the dilemma, especially serious in this type of case, of the accused's being forced by the risk of an adverse verdict to come forward to substantiate leads which he had previously furnished the government."

In the instant case, the government argued that the Leads Doctrine applies only to leads provided by the taxpayer. (Appendix 103a). It is patently outrageous to assume that the government may, under any circumstances, be permitted to ignore evidence tending to establish the innocence of anyone accused of a crime. The Holland case obviously teaches that a sound administration of the criminal law will acquit the innocent in net worth investigations where evidence of innocence is obtained - regardless of the source. This conclusion, so fundamental to the due process of the law, requires no further elaboration.

The information supplied by Joseph Wilson (Appendix 15a) to the Special Agent corroborated the petitioner's defense. If substantiated through investigative inquiry, the innocence of the petitioner would have been established. For purposes of illustration and emphasis the following is a listing of the relevant leads and the significant aspects of the information obtained from Wilson: (Appendix 44a et seq).

1. The petitioner admitted the following to Wilson:
   a. He had made enough money to retire for six or seven years.
   b. He could make $700.00 a night on the street.
   c. He had $1400.00 in cash on his person.
   d. He had an interest in a photography shop.
   e. He wanted to work at the Service Envelope Company so he would have a place to report his outside income.
   f. He admitted winning big at the racetrack.

2. Wilson observed the petitioner with large sums of cash.
3. Wilson stated that the petitioner was fired when he admitted selling envelopes in competition with his employer.
4. Wilson was a trustworthy witness.
5. Wilson had taken contemporaneous notes of certain conversations with the appellant.

The petitioner submits that it was the Special Agent's duty under the Leads Doctrine to fully investigate the Wilson information and other leads. This disregard of investigative responsibility was unconscionable and ultimately compelled the petitioner to assume the burden of proof.

The issue in Lenske v United States 383 F2d. 20 (9th Cir 1967) was similar in principal to the instant case. There the Special Agent failed to disclose or investigate third-party leads. The leads were disclosed during the cross-examination of the Special Agent. The Lenske court reached the obvious conclusion that the source of the lead is not dispositive of the governments obligation to investigate.

The court said:

> "The Supreme Court could not have meant that if the Special Agent who follows up the lead simply makes up his mind that the lead produces nothing of advantage to the prosecution, what his investigation discloses becomes a government secret, inaccessible to the defendant, although what the Special Agent learned by the use of the government's unlimited machinery of investigation might have been thought significant by a judge or a jury if they had been allowed to learn of it. The Court could not have meant that the Special Agent should be a tribunal empowered to decide criminal tax cases.

> Under the Holland teaching, a lead not furnished by the defendant but discovered by the Special Agent in his investigation would have at least equal status with a lead furnished by the defendant. The philosophy of Holland is that the trial of a tax fraud case by the net worth method places a defendant at a disadvantage dangerous to his liberty, and that some departure from the gamesmanship tactics of ordinary trials, even other criminal trials, is necessary to compensate for the disadvantage and make the contest more nearly equal."
> (emphasis supplied.)

In United States v Rully, 143 F Supp. 283 (DC Conn. 1956) the government failed to present evidence of leads to the jury. In that case, the government chose to ignore secondary evidence tending to corroborate the lead provided by the defendant.

The Court said:

> "...Where as here, the government has established the [net worth] bulge, the trier may weight all the evidence about the available source to which leads were given, and find the facts established by such evidence. If the government chooses to ignore a genuine lead, the trier cannot find that no sufficient funds came from that source..."

In the lower court, the government also argued that the lead information was not reasonably susceptible to being checked. (Appendix 106a et seq). The essential nature of the lead information was that the petitioner owned an asset in the opening year, namely cash. The

government argued that, since the case was earned in the "streets", it could not be investigated. The government's argument failed to confront the ultimate issue - the existence or nonexistence of the cash. At the close of the government's case, the record was replete with references to the fact that the petitioner was involved in various activities that would have generated cash (see infra page 4). The lead to be investigated and refuted was the alleged existence of an asset in the opening year. In this regard, the focus is transferred to the government's negation of cash on hand in the opening year.

LAW AND ANALYSIS -- THE LEADS DOCTRINE AND THE OPENING NET WORTH

In Merritt v United States, 327 F 2d. 820 (5th Cir 1964) the Special Agent testified that he failed to include all assets in the defendant's opening net worth. The government argued the asset was not included because of the investigative difficulty involved. The court concluded that the government had not established the opening net worth with "reasonable certainty", citing Holland. The court further concluded that there was no burden upon the defendant to tell the government anything.

After citing the "Leads Doctrine" in Holland, (see infra page 10) the court said:

> "...not only should the taxpayer not be required to substantiate leads previously furnished the Government but he also should not be required to substantiate the existence of assets uncovered by the Government in its own investigation..."

Merritt referred to the portion in Holland in which the Supreme Court stated that an essential condition to the legitimate use of the net worth method of proof is that the government must establish the opening net worth "with reasonable certainty".

The Holland Court said at 132:

> "We agree with petitioners that an essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets. The importance of accuracy in this figure is immediately apparent as the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset..."

In the instant case, the government failed to establish the opening cash on hand with "reasonable certainty"; its use of the indeterminate "dash" was misleading, confusing and represented an attempt to obscure and circumvent its burden to establish the petitioner's opening net worth accurately.

The cash hoard defense is typically negated when the government offers evidence inconsistent with the existence of the alleged cash. This usually takes the form of a reconstruction of the financial history of the taxpayer in pre-prosecution years. That principle was amply demonstrated and approved in Holland. There the taxpayer claimed the existence of a cash hoard and argued that the government failed to include that asset in the opening net worth. The court disposed of the taxpayer's claim in their analysis of whether the government had established a definite opening net worth. The court summarized the evidence offered by the government as follows: (at 133)

"During this period they lost their cafe' business; accumulated $35,000.00 in debts which were never paid; lost their household furniture because of an unpaid balance of $92.20; suffered a default judgment for $506.66; and were forced to separate for some eight years because it was to their "economical advantage." During the latter part of this period, Mrs. Holland was obliged to support herself and their son by working at a motion picture house in Denver while her husband was in Wyoming. The evidence further indicated that improvements to the hotel, and other assets acquired during the prosecution years, were bought in installments and with bills of small denominations, as if out of earnings rather than from an accumulation of $100 bills. The government also negated the possibility of petitioners accumulating such a sum by checking Mr. Holland's income tax returns as far back as 1913, showing that the income declared in previous years was insufficient to enable defendants to save any appreciable amount of money..."

The court concluded that the government had established its position with regard to cash on hand with reasonable certainty. The nature of the evidence convincingly demonstrated that the historical conduct of the taxpayer in financial affairs was inconsistent with the existence of a cash hoard and, therefore, the jury determination of that question was fully supported by the evidence.

Subsequent to Holland it became fundamental to successful prosecution by the net worth method for the government to conduct exhaustive investigations in order to establish the opening net worth.[1]

Another illustrative case on point is United States v Schipani, 293 F Supp 156 (E.D.N.Y. 1968). There, the defendant was indicted for the years 1956 through 1960. The government negated the cash hoard defense by presenting the following types of evidence:

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[1]The criminal investigations handbook for special agents, titled: Handbook for Special Agents, Internal Revenue Manual Chapter 9900 Section 324.4 states the following with regard to establishing the opening net worth: Establishing the Starting Point

(1) In the Holland case the Supreme Court said that an essential condition in a net worth determination of income is the establishment, "with reasonable certainty", of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's net worth. The wisdom of this statement is apparent since an inaccurate beginning net worth will affect the accuracy of the determination of income subsequent to the base point. For instance, if a taxpayer's beginning net worth is understated, taxable income for the period under consideration will be overstated.

(2) Proof of visible assets and liabilities comprising beginning net worth is usually easily established by such means as bank records; county real estate records, brokerage records, Bureau of Public Debt records, Federal and State Income, inheritance, and gift tax returns and records, and books and records of the taxpayer. To establish a firm starting point, it is necessary to show that the defendant had no large sum of cash for which he was not given credit. This is usually done by offering evidence which negates the existence of a cash hoard, for example:

(1) In 1940, the taxpayer borrowed $51.59 from a life insurance company. He did not fully repay this loan until 1947.

(2) A 1943 statement of assets showed $1,350 in cash.

(3) Taxpayer obtained two loans in 1944 in the amount of $205.

(4) Taxpayer was delinquent in the payment of numerous premiums on his insurance policies.

(5) In 1955, taxpayer financed the purchase of a new car. Thereafter, he was often delinquent in making the monthly installment payment.

(6) In 1955, a default judgment was entered against the taxpayer in the amount of $64.05.

(7) Taxpayer mortgaged his house in 1956. He was delinquent in several mortgage payments.

(8) In 1956, the taxpayer partially financed the purchase of a new car.

(9) In 1958, the taxpayer financed the purchase of a boat.

(a) Written or oral admissions of the taxpayer to the investigating officers concerning his net worth. Examples are: Signed net worth statement, oral statement as to cash on hand.
(b) Failure by defendant to file returns for years prior to indictment period.

In United States v Miriani, 422 F2d 150 (6th Cir 1970) the government conducted an exhaustive background investigation to establish the correctness of their opening net worth in order to negate the cash hoard defense. See also United States v Costello, 221 F2d 60 (2nd Cir 1955); United States v Vardine, 305 F2d 60 (2nd Cir 1962).

What clearly emerges from these cases is the conclusion that one of the most important elements of the government's proofs in negating the cash hoard defense is the presentation of sufficient evidence as to the opening net worth which makes the allegation of a cash hoard appear unlikely, improbable, and self-serving. In the instant case, with the exception of the opinions of the government agents and W-2 forms, there were no such offerings.

(c) Returns filed by the taxpayer for years prior to prosecution years reflecting income reported that is inconsistent with existence of a cash hoard. This would also apply to copies retained by the taxpayer.
(d) Low earnings for years prior to prosecution years as shown by records of the Social Security Administration and former employers.
(e) Net worth as established by books and records of the taxpayer.
(f) Certificate of Assessments and Payments showing tax assessed for years prior to the prosecution period. With this information and tables showing tax rates and the amount allowed for exemptions and dependents, it may be possible to calculate income reported by a taxpayer for the years in question. The certificate will not show amount of withholding, capital gains or nontaxable income.
(g) Financial statement presented for credit or other purposes at a time prior to or during the prosecution period. Banks, loan companies, bonding companies, and Internal Revenue Service (offers in compromise) are some of

A further defect in the government's proofs is found in its use of a "dash" as representing cash on hand. The government's expert witness testified that he used a "dash" because he didn't know how much cash the petitioner had as of December 31, 1970, (Appendix 78a). The only case located on point was United States v. Giacalone, 574 F2d 328 (6th Cir 1978). In that case, the government had conducted an intensive sixteen year background investigation and utilized a "dash" as opening cash on hand, the court said the use of a "dash" is sanctioned when the government has offered proof "which would support a finding that no significant cash hoard existed" and some factual basis exists upon which to justify the assertion that the "dash" represented an amount of cash that remained a constant throughout the years under investigation. In Giacalone, the government testified that the defendant was a gambler and that a gambler needed a bankroll of cash that would probably remain constant. The reasoning was accepted by the court. In the instant case, the government failed on both points. It not only failed to negate the existence of a substantial cash hoard, it also failed to provide any explanation or justification as to why the jury should or could assume that the petitioner's cash on hand remained a constant. The use of the "dash" in the instant case amounted to nothing more than an empty arithmetic contrivance, calculated to subtly shift the burden of proof to the petitioner.

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the better sources from which to obtain this type of document.
(h) Bankruptcy prior to prosecution periods.
(i) Prior indebtedness, compromise of overdue debts, avoidance of bankruptcy.
(j) Installment buying.
(k) History of prior low earnings and expenditures, and checks returned for insufficient funds.
(l) Loss of furniture and business because of financial reasons.

A final factor supportive of the petitioner's defense is that the government's use of net worth itself. The reconstruction clearly indicates that the vast majority of the petitioner's assets were paid for in cash. There was no evidence of any significant borrowing. (Appendix 110a). The government's case did not offer evidence of a likely source of taxable income for the year 1971. The Special Agent's testimony indicated no source for 1971. (Appendix 12a). The petitioner's operation of his horse training business in 1972 and 1973 was not a successful endeavor (see footnote 3, page 1). The government's net worth reconstruction is clearly susceptible to the interpretation that the source of the funds was prior accumulated cash on hand.

The inescapable conclusion is that the government's proof as to opening cash on hand was hopelessly deficient. The Special Agent received information that the petitioner may have had as much as $100,000.00[2] in 1970. This information corroborated the petitioner's

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[2]If the potential cash on hand is computed as a multiple of the total income reported by the petitioner in 1970 on his 1969 tax return, the resulting amount approximates the total alleged understatement:

ADJUSTED GROSS INCOME
per 1969 Form 1040
(Appendix 108a)

$ 16,914.19		$ 16,914.19	Averaged
x6		x7	Total
$ 101,485.14		$ 118,399.33	$109,942.24

ADJUSTED GROSS INCOME
per Net Worth Computations
(Appendix 112a)

1971	1972	1973	TOTAL
$34,223.08	$33,664.00	$41,231.10	$109,118.18

explanation. Further, the investigation disclosed that during the pre-prosecution years he was seen with large sums of money; he loaned money at high interest rates; he gambled successfully; he was fired from his job because he admitted to selling envelopes on the side; he may have had an interest in a photography studio and a security dog rental business; he said he could make $700.00 a night on the street; he said he wanted a sales job so he could have a way to report his outside income. Consider further that the majority of the petitioner's assets on the net worth statement were purchased with cash and that the government did not offer any evidence as to a likely source of income for 1971. Despite the overwhelming evidence that the petitioner could have accumulated substantial cash prior to 1971, the Special Agent decided that the leads would not be investigated. The Special Agent obviously saw no advantage in pursuing leads that might establish the innocence of the petitioner. Instead, the government produced W-2 forms to establish the opening cash on hand. The W-2 forms, in fact, established nothing. Where were the prior financial statements prepared by the petitioner? Where were the petitioner's tax returns before 1968? Where were the records of earnings from Social Security Administration? Where did the petitioner conduct his banking in 1970? Where was the evidence of prior loans and borrowing? Where was the evidence of installment and credit purchases? Where was the evidence of prior financial distress and poverty? Where was the evidence that any of these areas was investigated? The instant case did not establish the opening cash on hand with reasonable certainty. The evidence does not measure up to the burden imposed by Holland and exemplified in Schipani,

Miriani and Giacalone. The proofs are deficient because the government failed to investigate relevant leads as to cash on hand. Failing in this regard, the opening cash was not established with reasonable certainty. The failure to present all the potential evidence to the jury prevented the trier of fact from concluding that the petitioner's cash hoard was not the source of funds that accounted for the net worth increases. Thus deprived of that evidence, they should not have been empowered to conclude the ultimate issue of guilt or innocence. Thus it is respectfully submitted that the trial court erred in denying petitioner's motion for a Judgment of Acquittal.

7. RELIEF SOUGHT

WHEREFORE, for the reasons stated above, Petitioner RAYMOND E. SMITH, prays his Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit be favorably considered, and granted.

Respectfully submitted,

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Member of the Bar of the
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Dated: December 7, 1979

FILED

NOV 13 1979

JOHN P. HEHMAN, Clerk

No. 79-5111

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

UNITED STATES OF AMERICA,)

Plaintiff-Appellee,)

v.) ORDER

RAYMOND E. SMITH,)

Defendant-Appellant.)

Before: EDWARDS, Chief Circuit Judge, CELEBREZZE and LIVELY, Circuit Judges.

Raymond E. Smith appeals from his jury conviction for willfully evading payment of income taxes in violation of 26 U.S.C. § 7201. In the appeal Smith contends that the district court erred in denying his motion for acquittal because the government did not investigate relevant and exculpatory pre-trial leads, resulting in a failure of the government's proof to establish Smith's opening net worth with reasonable certainty when using the net worth method of proof.

Under the net worth method of proof, the government seeks to compute taxable income by determining a taxpayer's net worth at the end of each year plus his nondeductible expenditures during the year. The difference between this figure and the net worth figure at the beginning of the year is

treated as the taxable income received during the year.

The net worth method of proof in income tax evasion cases was approved by the Supreme Court in Holland v. United States, 348 U.S. 121 (1954). The Court stated that"an essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets." To this end the Court imposed upon the government an obligation to investigate all "leads" furnished by the taxpayer relative to non-taxable sources which are "reasonably susceptible of being checked." In analyzing the "leads" alleged by appellant the district court concluded that all leads that could reasonably be investigated were, in fact, pursued by an I.R.S. Agent. The other "leads" were either unknown to the government before trial, involved insignificant amount of money, or could not reasonably be investigated.

Relying on United States v. Giacalone, 574 F. 2d 328 (6th Cir.), cert. denied, 99 S.Ct. 114 (1978), the district court also concluded that the inability of the government to establish a figure for "cash on hand" did not invalidate the net worth statement. In that case this court appoved a net worth

statement that did not contain a figure for "cash on hand," stating that even if the evidence showed that there was cash on hand, it was for the jury to determine whether there was enough to account for the net worth increase.

With respect to the issues raised by appellant, we conclude that the government established appellant's opening net worth with the "reasonable certainty" required by law, and adequately investigated the leads which were reasonably susceptible of being checked.

Accordingly, it is ORDERED that the judgment of the district court be, and hereby is, affirmed.

ENTERED BY ORDER OF THE COURT

John P. Hehman
Clerk

Supreme Court, U. S.
FILED
JAN 80 1980
MICHAEL RODAK, JR., CLERK

No. 79-909

In the Supreme Court of the United States

OCTOBER TERM, 1979

RAYMOND E. SMITH, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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M. CARR FERGUSON
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OPINIONS BELOW

The district court issued no written opinion. The court of appeals' order of affirmance is unpublished (Pet. App. 1-3).

JURISDICTION

The judgment of the court of appeals was entered on November 13, 1979. The petition for writ of certiorari was filed on December 11, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the government met its burden in establishing petitioner's opening net worth with reasonable certainty in this criminal tax evasion case prosecuted under the net worth method of proof.

STATEMENT

After a jury trial in the United States District Court for the Eastern District of Michigan, petitioner was convicted on two counts of willfully attempting to evade and defeat his income taxes for 1971 and 1972, in violation of 26 U.S.C. 7201.[1] The district court sentenced petitioner to one year's imprisonment and a fine of $20,000. The court of appeals affirmed (Pet. App. 1-3).

The government employed the net worth plus nondeductible expenditures method of proof. The evidence produced, and stipulated to by the defense, showed that during the prosecution years petitioner purchased real estate, automobiles, a boat, four racehorses, furniture and carpeting, and that his net worth apparently increased by $36,968.20 in 1971 and $31,268.33 in 1972 (A. 110a-112a).[2] After allowances for personal expenditures, tax deductions and credits, and various losses, the evidence adduced at trial showed that petitioner had understated his taxable income by $34,223 for 1971 and $32,158 for 1972 (A. 112a).

At the close of the government's case, petitioner moved for a judgment of acquittal on the ground that the government failed to investigate certain exculpatory leads (A. 97a-99a). The trial court denied the motion. It agreed with the government's submission that the leads were either not reasonably susceptible of being investigated or involved insignificant amounts of money (A. 106a-107a).

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[1]Petitioner was acquitted on a third count for 1973.

[2]"A." refers to the joint appendix filed in the court of appeals.

ARGUMENT

1. The net worth plus nondeductible expenditures method of proving income tax evasion is a well-established and judicially accepted method of prosecution in cases where the taxpayer's records are inadequate as a basis for determining income tax liability. Under the net worth method of proof, the government establishes the total net value of the taxpayer's assets at the beginning of a given year. Thereafter, the government proves the total net value of the taxpayer's assets at the end of that year and at the end of each succeeding year of the period under scrutiny, and computes the difference between the net values of the taxpayer's assets as of the beginning and end of each year. Nondeductible expenditures, such as living expenses, are added to the annual increases. If the resulting figure for any year substantially exceeds the taxpayer's reported taxable income for that year, the excess is treated as unreported taxable income, provided the government establishes a likely source of taxable income for the net worth increases or negates nontaxable sources for the net worth increases. *Holland* v. *United States*, 348 U.S. 121, 125-126, 137-138 (1954); *United States* v. *Massei*, 355 U.S. 595 (1958).

a. Petitioner contends (Pet. 12-13) that the government failed to establish his opening net worth with reasonable certainty, as required by *Holland* v. *United States*, *supra*, because it failed to investigate certain leads concerning cash accumulated during prior years that would have been sufficient to account for the apparent net worth increases during the prosecution years. In support of this argument, petitioner points to the testimony of Joseph Wilson, one of his fellow employees at Service Envelope Company. Wilson testified that petitioner told him in the year preceding the first prosecution year (with one exception) that he had made

enough money to retire for six or seven years;[3] that he could make $700 a night on the street; that he had $1,400 in cash on his person; that he had an interest in a photography shop; that he wanted to continue working at Service Envelope so that he would have a place to report his outside income; and that he had substantial racetrack winnings (A. 48a, 51a-53a, 62a-63a). Wilson also testified that on one occasion he saw petitioner with a large sum of cash (A. 61a).

There is, however, little in the record to establish that the information Wilson revealed in his testimony was made known to the Internal Revenue Service agent who investigated petitioner's tax liability (see A. 10a-16a, 46a-47a, 68a). Petitioner did not supply any leads to possible non-taxable sources for the net worth increases to the investigating agent (A. 100a-102a). Instead, petitioner's attorneys told the agent that the apparent net worth increases were attributable to expenditures from cash savings which petitioner had accumulated from continuous employment during pre-indictment years and to loans and cash gifts from family members (A. 10a-11a). The agent obtained petitioner's payroll information dating back to 1957, when petitioner began his employment. The agent determined that petitioner could not have saved enough from his wages to account for the increases in net worth (A. 8a-11a, 78a-79a). The agent also spoke to petitioner's mother and was told that she was not aware of any loans, inheritances, or gifts to petitioner (A. 11a).

The agent also testified that during his investigation he heard that the petitioner may have earned income renting Doberman Pinscher dogs to J.L. Hudson Co.,

[3]This statement was made on March 25, 1971, during the first prosecution year (A. 50a-51a).

but that the firm could not confirm that allegation for the agent (A. 12a). Finally, the agent testified that these were the only leads he received during the course of his investigation (A. 12a) and that he fully investigated those leads.[4] Accordingly, the investigating agent did not know the information in Wilson's testimony.

b. Even on the assumption that the information in Wilson's testimony was known to the government prior to trial, the government's failure to investigate that information would not have required a reversal. The government is only required to investigate leads that can reasonably be checked and that, if true, would establish the taxpayer's innocence.[5] *United States* v. *Ramsdell*, 450 F. 2d 130, 132 (10th Cir. 1971). Where there are no means of effectively investigating the leads (*e.g.*, names of potential witnesses, specific dates, records, *etc.*), the government is not required to investigate. *United States* v. *Ramsdell*, *supra*, 450 F. 2d at 132-133. In light of the

[4]The agent also testified that he did not interview anyone with whom petitioner was likely to have been associated prior to the prosecution years because he did not have the names of any such people, and that he did not interview anyone who had served with petitioner in the Army because he did not have petitioner's serial number, and petitioner's attorneys refused to supply it when he asked them to do so (A. 15a-16a).

[5]Another of petitioner's fellow employees, Walter Zub, testified, without specifying the years involved, that petitioner would lend money to his fellow employees in return for payment of 25 cents for each dollar loaned (A. 71a-72a). Zub never heard of anyone borrowing any more than $10 (A. 72a). Even assuming that the investigating agent was aware of this information prior to trial, the trial court correctly concluded that, at best, this evidence indicated the possible accumulation of only an insignificant amount of money (A. 107a)—which could not have accounted for the large increases in net worth and would not have been material to show petitioner's innocence.

vague unspecified nature of Wilson's testimony, the courts below correctly ruled that the government was not required to investigate these "leads" (Pet. App. 2).

2. Petitioner further argues (Pet. 15-20) that the government's proof was inadequate to show that the amount of cash on hand at the beginning of the prosecution period was insufficient to account for the net worth increases. But the investigating agent examined petitioner's payroll information dating back to 1957 and determined that petitioner could not have accumulated a cash hoard sufficient to account for the net worth increases during the prosecution years (A. 8a-11a, 78a-79a). This conclusion was corroborated by the fact that the petitioner worked substantial amounts of overtime prior to the prosecution years (A. 39a) and by petitioner's statements to Wilson, his fellow employee, made about three months before the first prosecution year, that he wanted a leave of absence so that he could get established in his own business before quitting Service Envelope, that he wanted something to fall back on if he did not succeed in his outside ventures, and that he would not be back to work if his outside ventures were successful (A. 48a, 53a). From this evidence, the jury could have reasonably concluded that petitioner had no outside source of income prior to the prosecution years to account for the subsequent increases in his net worth.

In short, petitioner was free to attempt to establish that he had a substantial amount of cash on hand at the starting point, and it was for the jury to resolve that factual question. *United States* v. *Mackey*, 345 F. 2d 499, 506 (7th Cir.), cert. denied, 382 U.S. 824 (1965); *Fowler* v. *United States*, 352 F. 2d 100, 107 (8th Cir. 1965), cert. denied, 383 U.S. 907 (1966). There was, however, ample evidence to support the conclusion that

petitioner had insufficient cash on hand at the beginning of the prosecution years to account for the net worth increases during the prosecution years.

In these circumstances, petitioner errs in his final argument (Pet. 21) challenging the government's use of a hyphen in its net worth computations to represent that petitioner had an undetermined amount of cash on hand that was insufficient to account for the large increases in his net worth during the prosecution years (A. 11a). *United States* v. *Giacalone*, 574 F. 2d 328 (6th Cir.), cert. denied, 439 U.S. 834 (1978). It is settled that exact precision as to cash on hand is not required in a net worth case. See, *e.g.*, *United States* v. *Carter*, 462 F. 2d 1252 (6th Cir.), cert. denied, 409 U.S. 984 (1972); *United States* v. *Bush*, 512 F. 2d 771 (5th Cir. 1975); *United States* v. *Mackey*, *supra*.[6]

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[6]Petitioner contends (Pet. 22) that the government did not establish a likely source of taxable income for the net worth increases. But by his own admission made on March 23, 1971, during the first prosecution year, petitioner was earning enough from his outside business ventures so that he would not have to work for six or seven years (A. 50a-51a).

CONCLUSION

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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JANUARY 1980

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